Irish Tax Institute

March 2022

Territorial System of Taxation

Response to Public Consultation

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1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 30,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, and the Taxation Institute of Hong Kong. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

2. Executive Summary

The Institute welcomes the opportunity to contribute to the public consultation on a territorial system of taxation.

Currently, the rules concerning relief from double taxation on foreign earnings are set out in Schedule 24 of the Taxes Consolidation Act 1997 (TCA 1997). The provisions are complex with the result that there is a significant compliance burden involved when claiming double taxation relief. However, as acknowledged in the Consultation Paper[1], the application of Schedule 24 often results in limited amounts of incremental tax becoming payable in Ireland on foreign earnings.

Previously, the policy rationale for not adopting a territorial tax system was that Ireland did not have controlled foreign company (CFC) legislation to prevent the artificial diversion of profits to other jurisdictions. However, EU Anti-Tax Avoidance Directive[2] (ATAD) compliant CFC rules were introduced into Irish law by Finance Act 2018. In addition, the recent introduction of extended transfer pricing rules, ATAD Interest Limitation Rules (ILR) and anti-hybrid rules further protect Ireland's domestic tax base from the artificial diversion of profits and base erosion.

Joining the OECD Inclusive Framework international tax agreement on a Two-Pillar Solution to Address the Tax Challenges of Digitalisation[3] (Two-Pillar Solution) reduces Ireland's scope to compete for foreign direct investment based on its corporation tax rate. Consequently, it is now more important than ever for policymakers to consider other ways to improve the Irish tax system and enhance Ireland's attractiveness as a place to do business.

We believe that simplifying the Irish corporation tax code and making it easier to administer would enhance the country's competitiveness. The absence of a participation exemption puts Ireland at a disadvantage when competing for foreign direct investment with other OECD and EU countries that operate exemption systems. Moving to a territorial system of taxation would reduce the administrative burden for Irish companies with international operations and simplify how double taxation relief would be available in Ireland on such foreign earnings. It would bring Ireland's corporation tax code in line with most OECD countries and EU Member States.

Companies are currently evaluating the potential impact of the OECD Two-Pillar Solution on their business and making decisions regarding how to structure their operations going forward. The existence of a participation exemption in the Irish corporation tax code will be a key factor for such companies when determining where to locate future investment and is already impacting decisions. In addition, a participation exemption would encourage international growth and development by Irish headquartered multinationals.

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[1] Department of Finance, Consultation on a Territorial System of Taxation, December 2021.

[2] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

[3] OECD/G20 Inclusive Framework on BEPS, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021.

Such companies have made considerable investments in Ireland, provide high quality jobs and contribute significantly to the Irish economy.

In our view, a participation exemption and foreign branch exemption should be introduced without delay to ensure Ireland remains an attractive location for investment. If policymakers do not intend to include measures in Finance Bill 2022 to introduce a participation exemption and foreign branch exemption into Irish law, we would urge the Government to provide a firm commitment this year to do so, setting out a clear timeline for implementation. Such a commitment would provide the necessary certainty to business over a critical issue, which is already a key influential factor in the decision-making process regarding long-term investments in Ireland in the coming years.

We have summarised in section 3 of this submission, the Institute's detailed recommendations for a territorial system of taxation and we have outlined in further detail our responses to the consultation questions in section 4. However, it is important that policymakers consider the following key matters when evaluating a move to a territorial tax system:

- A participation exemption for dividends and a foreign branch exemption should be adopted into Irish tax legislation to help simplify the Irish corporation tax code, to protect the country's ability to attract foreign direct investment and to encourage international growth and development by Irish headquartered multinationals.

- Considering the base erosion protections which exist in Ireland's corporation tax code, including CFC rules, extended transfer pricing rules, ATAD ILR and anti-hybrid rules, we believe that the rules governing a participation exemption and a foreign branch exemption should be clear and simple with limited exceptions and that the exemptions should have a broad territorial scope.

- Both a participation exemption for dividends and a foreign branch exemption should be at the election of taxpayers.

- While the introduction of a participation exemption and a foreign branch exemption must be the priority, we recommend that a simplification of Schedule 24 is also undertaken. Such simplification is necessary even if Ireland adopts a participation exemption for dividends and a foreign branch exemption as Schedule 24 will continue to have application to foreign income which is outside the scope of such exemptions.

The Institute would be happy to engage further in this consultation through stakeholder meetings or direct discussions. Please contact Anne Gunnell at agunnell@taxinstitute.ie or (01) 6631750 if you require any further information.

3. Institute Recommendations

Policy Benefits of Participation Exemption and/or Branch Exemption Regimes

1. We recommend that Ireland introduces both a participation exemption and foreign branch exemption. As most OECD and EU countries operate a territorial tax system, the absence of a participation exemption and foreign branch exemption can put Ireland at a competitive disadvantage when competing for foreign direct investment as businesses operating internationally favour the simplicity and certainty that such exemptions provide for relevant foreign income. In addition, a participation exemption would encourage international growth and development by Irish headquartered multinationals.

2. In our view, Ireland should move quickly to introduce a participation exemption and a foreign branch exemption to ensure Ireland remains an attractive location for investment. If it is not intended to legislate for these measures in Finance Bill 2022, it is essential that there is a firm commitment signalled by Government this year to do so, setting out a clear timeline for implementation. Such a commitment would provide the necessary certainty to business over a critical issue, which is already a key influential factor in the decision-making process regarding long-term future investments in Ireland.

Scope of Exemption Regimes

3. With a view to simplifying the corporation tax code and protecting the country's competitiveness for foreign direct investment, we recommend that Ireland adopts a participation exemption with limited exceptions, which applies to all foreign source dividends, irrespective of whether they are derived from treaty or non-treaty jurisdictions. Designing the participation exemption in this manner would increase the attractiveness of Ireland as a location for investment compared with other competitor countries, such as the Netherlands and the UK.

4. In our view, the participation exemption should apply at the election of the taxpayer to all foreign source dividends, irrespective of whether they are derived from treaty or non-treaty jurisdictions.

5. We do not believe that the participation exemption should be limited to dividends paid out of trading profits of companies as this would add unnecessary complexity and uncertainty for investors regarding the availability of the exemption.

6. In our view, Ireland should adopt a foreign branch exemption which applies at the election of the taxpayer.

7. The branch exemption should apply to profits arising in a foreign branch in any jurisdiction outside Ireland and should extend to profits in the nature of income or capital gains arising to the branch. If policymakers believe the foreign branch exemption should apply to a definitive category of jurisdictions, consideration could

be given to restricting the branch exemption to jurisdictions to which Section 21B TCA 1997 applies.

8. As the automatic application of a branch exemption could result in the denial of relief for branch losses, in our view, a company should have the option to apply the foreign branch exemption on a branch-by-branch basis at the election of the company.

Interaction with CFC Rules

9. In adopting a foreign branch exemption, the Irish CFC rules will need to be extended in line with the EU Anti-Tax Avoidance Directive[4] (ATAD) to ensure the rules apply to the undistributed income of foreign branches where the relevant conditions are satisfied, and the Irish resident company has opted to apply the foreign branch exemption.

10. Where a company receives a dividend from a CFC it could elect to apply a participation exemption to that dividend. Policymakers may wish to consider amending the CFC rules to ensure a CFC charge cannot be averted in those circumstances, solely on the basis that the CFC has no undistributed income.

Interest Charges associated with Exempt Income

11. Stringent and complex conditions governing tax relief for funding costs are contained in various sections of the tax code providing strong protections for the Irish corporation tax base. Furthermore, the ATAD Interest Limitation Rules (ILR) introduced in Finance Act 2021 limit the net interest deductions of a company within the charge to Irish corporation tax to 30% of EBITDA. In our view, imposing further restrictions on interest relief for the funding costs of investments in circumstances where a participation exemption applies to the dividends derived from that investment are unwarranted.

12. The ATAD ILR was layered on top of existing interest deductibility provisions making the operation of the interest deductibility rules overly complex and resulting in Ireland having one of the most complicated interest deductibility regimes within the EU. This makes it difficult for businesses to operate in Ireland and comply with their tax obligations. In our view, policymakers should consider a redesign of Ireland's corporation tax regime for interest deductibility to rebalance the effect of the comprehensive protections already afforded within the existing regime, with those now available under recently introduced ILR, anti-hybrid measures and extended transfer pricing rules.

Exit Tax

13. In adopting a foreign branch exemption, it will be necessary to amend the exit tax provisions contained in Section 627 TCA 1997 to ensure alignment with ATAD.

[4] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

However, in amending the exit tax rules, care would need to be taken to ensure that exit tax would not apply where a taxpayer elects not to apply a foreign branch exemption.

Schedule 24

14. While the introduction of a participation exemption for dividends and a foreign branch exemption must be the priority, we recommend that a simplification of Schedule 24 is also undertaken. Such simplification is necessary even if Ireland adopts both exemptions as Schedule 24 will continue to have application to foreign income which is outside the scope of such exemptions.

15. With the implementation of the GloBE rules including a minimum effective tax rate of 15%, we believe that it is now appropriate for policymakers to consider eliminating the distinction between trading and non-trading activities. In the absence of such a change, we believe that a reformed Schedule 24 could distinguish between income sources on the basis of income derived from a company's trading income taxable at 12.5% and passive investment income taxable at 25%.

16. There are components of Schedule 24 which, if simplified, would alleviate the administrative burden. We believe the varying treatment between different categories of income (for example, interest and royalties) should be removed to determine foreign tax credits and the pooling and carry forward of excess credits. Ensuring consistency of treatment across the different categories of income would simplify the current system and address much of the complexity faced by businesses in applying Schedule 24.

Interaction with Anti-Hybrid Rules

17. Section 835AB TCA 1997 deals with the application of the anti-hybrid rules in the context of a worldwide system of taxation. In adopting a participation exemption for dividends and/or a foreign branch exemption, it is essential that section 835AB TCA 1997 is retained as its application will continue to be necessary in certain circumstances to ensure that the impact of the anti-hybrid rules is confined to actual economic hybrid mismatches and not technical hybrid mismatches.

Interaction with the Two-Pillar Solution

18. We believe the implementation of the GloBE rules, together with the other protections in the corporation tax code, such as CFC rules and exit tax, should alleviate any concerns regarding the potential for base erosion in respect of in-scope multinational enterprises on moving from a worldwide tax system to a territorial system of taxation. In our view, adopting a participation exemption would also better align the Irish corporation tax code with the GloBE rules.

Ireland's Double Taxation Treaty Network

19. We do not believe that adopting a participation exemption and/or a branch exemption into domestic tax legislation would impact Ireland's tax treaties as the intended purpose of both exemptions would be to avoid double taxation arising. However, going forward, as Ireland re-negotiates its double taxation treaties in the normal course, it would be appropriate for such treaties to reflect the existence of a participation exemption and/or branch exemption in Irish tax law.

4. Consultation Questions

4.1. Policy Benefits of Participation Exemption and/or Branch Exemption Regimes

Q1. What is your opinion of Ireland's corporate tax potentially moving from the current worldwide system with credit relief for foreign tax to a territorial system of double taxation relief, including participation exemption and/or branch exemption provisions?
Q2. What would the broad benefits be for multi-national enterprises if Ireland were to move to such a system?
Q3. Are there any particular drawbacks or concerns for multi-national enterprises which should be considered if Ireland were to move to such a territorial system of double tax relief, including any indirect consequences or risks?
Q4. Are there particular examples of best practice associated with a change to territoriality in other jurisdictions which could be considered, with a view to reducing compliance burdens without increasing avoidance risks?

In October 2021, the Government confirmed it would join the OECD Inclusive Framework agreement to reform international tax rules to address the challenges arising from the digitalisation of the global economy. The announcement came following confirmation that the proposed minimum effective tax rate had been set to a precise rate of 15%.

Joining the OECD Inclusive Framework international tax agreement reduces the scope of competition for foreign direct investment in respect of Ireland's corporation tax rate. It is now more important than ever for policymakers to consider other ways to improve the tax system and enhance Ireland attractiveness as a place to do business.

Simplifying the Irish corporation tax code and making it easier to administer would improve the country's tax competitiveness. The rules concerning relief from double taxation on foreign earnings are set out in Schedule 24 TCA 1997. Unilateral relief apples where there is no double taxation treaty in place. In many instances, the outcome where unilateral relief applies as opposed to where there is a tax treaty can be very similar.

Irish rules governing relief from double taxation are complex, resulting in a significant administrative compliance burden for businesses to claim relief. To obtain the data necessary to determine the available double tax credit relief, an extensive exercise is required, in particular where there are complex holding structures with tiers of companies, to trace the source of foreign dividends and identify the correlating foreign tax credit. Even though, as acknowledged in the Consultation Paper, the application of Schedule 24 often results in limited amounts of incremental tax becoming payable in Ireland on foreign earnings.

Moving to a territorial system of taxation would simplify the rules governing double taxation relief in respect of relevant foreign income and consequently, reduce the associated administrative burden. The absence of a participation exemption puts Ireland at a disadvantage when competing for foreign direct investment with other OECD and EU countries that operate exemption systems.

A participation exemption could enhance the competitiveness of Ireland's corporation tax regime if the rules are drafted in such a manner that would ensure simplicity and provide the necessary certainty to business. In addition, a participation exemption would encourage international growth and development by Irish headquartered multinationals. Such companies have made considerable investments in Ireland, provide high quality jobs and contribute significantly to the Irish economy.

Companies are currently evaluating the potential impact of the OECD Two-Pillar Solution on their business and making decisions regarding how to structure their operations going forward. The existence of a participation exemption in the Irish corporation tax code will be a key factor for such companies in determining where to locate their business and investment.

The implementation of a global minimum tax rate, on top of the adoption of extensive measures contained in the Anti-Tax Avoidance Directives, including controlled foreign company (CFC) rules, to protect against foreign base erosion risks, diminishes the need for a worldwide corporate tax system. Previously, the policy rationale for not moving to a territorial tax regime was that Ireland did not have CFC rules which would prevent the artificial diversion of profits to subsidiary companies in other jurisdictions. However, Irish CFC rules were introduced in Finance Act 2018.

In adopting a participation exemption for foreign source dividends and a foreign branch exemption in Ireland, it would be important that companies have the option to elect to apply both exemptions. Companies have structured their businesses so that they can repatriate profits to Ireland and avail of credit, deduction, pooling and carry-forward entitlements as set out in Schedule 24 TCA 1997 in circumstances where there is a double taxation treaty in place and also where unilateral relief provisions apply. Depending on the countries in which a business may be located, the benefit of credit pooling could be diminished following a move to a territorial system of taxation if the option to elect out of the regime is not provided.

In our view, Ireland should move quickly to introduce a participation exemption and a foreign branch exemption. If policymakers do not intend to include measures in Finance Bill 2022 to introduce both exemptions into Irish law, we would urge the Government to provide a firm commitment this year to do so, setting out a clear timeline for implementation. Such a commitment would provide the necessary certainty to business over a critical issue, which is already a key influential factor in the decision-making process regarding long-term investments in Ireland in the coming years.

4.2. Scope of Exemption Regimes

Q5. Taking account of the above, what in your view would be the potential impacts of moving to a participation exemption regime as set out in the Coffey Report?
Q6. Are there particular considerations or design features that should be considered in reviewing the basis of the Irish corporation tax system?
Q7. Taking account of, but not limited to, the design elements above, what in your view would be the best regime for Ireland to transition to, should a change take place? Please elaborate with consideration of the impacts, benefits and potential drawbacks both of (a) your preferred approach and (b) any approaches which you do not think would be beneficial.

The Consultation Paper suggests that a participation exemption could be limited to trading profits from companies and that a foreign branch exemption could be limited to branch trading income. It also suggests that the exemptions could be limited to specified categories of jurisdictions, such as tax treaty countries and EU Member States, while retaining the worldwide charge with credit for foreign tax for other jurisdictions not in scope, for example, the EU Code of Conduct non-cooperative listed jurisdictions.

Following Ireland's commitment to the OECD base erosion and profit shifting (BEPS) project and the transposition of the EU Directives, ATAD1[5] and ATAD2[6], into Irish law, extensive reforms have been implemented in domestic legislation over recent years to eliminate BEPS opportunities. These reforms, including CFC rules, extended transfer pricing rules, ATAD ILR and anti-hybrid rules, protect Ireland's domestic tax base against the artificial diversion of profits and base erosion.

Given the extensive base erosion protections which already exist in the Irish corporation tax code, we believe that the rules governing a participation exemption and a foreign branch exemption should be clear and simple with limited exceptions and the exemptions should have a broad territorial scope, which is not limited to double taxation treaty partners.

Participation Exemption

The lack of a participation exemption for foreign dividends can put Ireland at a disadvantage in competing for foreign direct investment. With a view to simplifying the corporation tax code and protecting the country's competitiveness, we believe that Ireland should adopt a participation exemption with limited exceptions, which would

[5] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
[6] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

apply to all foreign source dividends irrespective of whether they are derived from treaty or non-treaty jurisdictions. Designing the participation exemption in this manner would increase the attractiveness of Ireland as a location for investment compared with other competitor countries, such as the Netherlands and the UK.

It is worth noting that under the Pillar Two Global anti-Base Erosion (GloBE) Model Rules, when adjusting an entity's financial accounting income to exclude dividends in order to arrive at the entity's GloBE income figure, no distinction needs to be made between dividends received from treaty and non-treaty countries.

The Consultation Paper suggests that a participation exemption for foreign source dividends could be limited to dividends paid out of trading profits of companies, with the definition of such profits drawing upon section 21B TCA 1997, which concerns the taxation of foreign dividends. In our view, the exemption should not be limited to dividends paid out of trading profits of companies as this would add unnecessary complexity and uncertainty for investors regarding the availability of the exemption.

In designing a participation exemption for dividends, we believe it would be reasonable to impose a minimum ownership requirement. For example, policymakers could consider imposing a condition similar to that which applies to the participation exemption for gains in section 626B TCA 1997. This would limit the availability of the participation exemption to dividends where the Irish resident company has a direct or indirect interest of at least 5% in the company from which the dividend is ultimately sourced.

In the event that the participation exemption for dividends is restricted to companies resident in tax treaty or EEA territories, in order to determine if the dividend is paid by a company in such a territory, it would be important that the dividend should be capable of being tracked through any number of intermediary layers to determine that it is paid by a company located for tax purposes in a qualifying jurisdiction.

Policymakers may also wish to consider imposing a condition which would deny the participation exemption in circumstances where the payor has received a tax deduction for the dividend. This approach would align with Ireland's existing anti-hybrid mismatch rules.

Foreign Branch Exemption

In our view, Ireland should adopt a foreign branch exemption which applies at the election of the taxpayer. The exemption should apply to profits arising in a foreign branch in any jurisdiction outside Ireland.

We consider that the branch exemption should extend to profits in the nature of income or capital gains arising to the branch. For example, capital gains arising on the disposal of assets held by the branch or upon a sale or cessation of the branch business should come within the scope of the exemption. In our view, post cessation trading receipts should also come within the scope of the exemption.

Interestingly, under the rules of the foreign branch exemption which applies in the UK, UK resident companies can elect for profits of their foreign branches to be exempt from UK taxation and the exemption applies to the branch's trading profits, investment income connected with the branch and chargeable gains. There is no requirement for the foreign branch of the UK company to be located in a treaty jurisdiction.

If policymakers believe that the foreign branch exemption should apply to a definitive category of jurisdictions, consideration could be given to restricting the branch exemption to the jurisdictions to which section 21B TCA 1997 applies. This would include EU Member States, countries with which Ireland has a double taxation treaty in force or with which Ireland has signed a double taxation treaty which has yet to come into force, and countries which have ratified the Joint Council of Europe / OECD Convention on Mutual Assistance in Tax Matters.

As the automatic application of a branch exemption could result in the denial of relief for branch losses, in our view, a company should have the option to apply the foreign branch exemption on a branch-by-branch basis at the election of the company and that there would be the possibility to revoke the election. Where a company elects not to apply the branch exemption, the existing methodology for relief for double taxation under the provisions of Schedule 24 TCA 1997 would apply.

From an administration perspective, rather than imposing additional compliance burdens on companies, it would be helpful if a taxpayer could elect to apply for the branch exemption in the corporation tax return (Form CT1) for the relevant year in which they wish to first apply the exemption to the branch.

Policymakers could consider restricting the availability of the branch exemption to circumstances where the profits of the branch are considered to be subject to tax in the foreign jurisdiction (i.e., the exemption would not be available if the branch is not recognised as a taxable presence in the branch jurisdiction). This approach could be aligned with the anti-hybrid mismatch measures that apply in respect of branches.

Policymakers may wish to consider the use of transitional measures where tax relief has previously been claimed for branch losses.

4.3. Interaction with CFC Rules

Q8. Please outline your view of whether Ireland's CFC rules would be adequately aligned with participation exemption and/or branch exemption regimes should these be introduced. What synergies or risks, if any, do you foresee arising?
Q9. Please identify any particular design features of these exemption regimes that could have positive or negative impacts in this context? Please elaborate.
Q10. Please identify any adaptations to Ireland's CFC rules that should be considered in conjunction with the introduction of such exemption regimes.

ATAD complaint CFC rules were introduced into Irish law by Finance Act 2018, which prevent the artificial diversion of profits from controlling companies to CFCs. The rules operate by attributing undistributed income of a CFC to a controlling company or a connected company in Ireland.

As the income of a foreign branch of an Irish company is treated as the income of the company for Irish tax purposes under the worldwide system, the Irish CFC rules do not currently apply to foreign branches. However, ATAD recognises that a permanent establishment (PE) can be a CFC and notes that it is necessary for CFC rules to extend to the profits of PEs where those profits are not subject to tax or are tax exempt in the Member State of the taxpayer.

Therefore, in adopting a foreign branch exemption, Irish CFC rules would need to be extended in line with ATAD to ensure they apply to the undistributed income of foreign branches where the relevant conditions are satisfied, and the Irish resident company has opted to apply the foreign branch exemption.

Under Irish CFC rules, no CFC charge arises where the CFC does not have undistributed income. However, as a PE cannot issue dividends, it would be necessary to consider what constitutes undistributed income of a PE for the purposes of the CFC rules.

If a company opts to apply a participation exemption to a dividend which it receives from its CFC, under the current CFC rules, this could result in a CFC charge not applying to that income on the basis that the CFC has distributed that income. Policymakers may wish to consider amending the CFC rules to ensure a CFC charge cannot be averted solely on the basis that the CFC has no undistributed income in such circumstances.

4.4. Interest Charges associated with Exempt Income

Q11. In your view, should tax relief for funding costs of investments be reviewed, with a view to restrictions, if foreign income from such investments were to be exempted? What EU law or tax treaty constraints, if any, might impede such restrictions?

The rationale for restricting tax relief for the funding costs of investments on the basis that foreign income from such investments is to be exempted is unclear. The policy intention for providing relief for interest costs is to encourage investment in Ireland and should not be conditional on a taxable distribution in the future.

The Consultation Paper suggests that tax relief for funding costs of investments may need to be reviewed, with a view to restrictions, if foreign income from such investments were to be exempted. No such restriction exists for the purposes of section 626B TCA 1997 which exempts capital gains accruing on the disposal of certain holdings in subsidiaries. In respect of relief under section 247 TCA 1997, there is no such qualification for companies in receipt of franked investment income.

Indeed, section 247(4A) already limits the relief available where the borrower is connected with the lender in circumstances where there is not 'relevant income', which includes dividends or other distributions chargeable to corporation tax. Furthermore, Finance Act 2017 amended the interest deductibility provisions under section 247 to allow relief for investments held indirectly through one or more intermediate holding companies.

Stringent and complex conditions governing tax relief for funding costs contained in various sections of the corporation tax code provide strong protections for the Irish corporation tax base. Moreover, the ATAD ILR introduced by Finance Act 2021 limits the net interest deductions of a company within the charge to Irish corporation tax to 30% of EBITDA.

In our view, imposing further restrictions on interest relief for funding costs of investments in circumstances where a participation exemption would apply to the dividends derived from that investment is unwarranted

Restricting the availability of interest relief on the funding costs of investment in a subsidiary in circumstances where a dividend from that would be subject to a participation exemption could be contrary to the EU fundamental freedoms (i.e. the freedom of establishment and free movement of capital), on the basis that such a measure would discriminate between relief for investments made in an Irish subsidiary compared with a foreign subsidiary.

The ATAD ILR was layered on top of existing interest deductibility provisions making the operation of the rules overly complex, resulting in Ireland having one of the most complicated interest deductibility regimes within the EU. It has created challenges for businesses to operate in Ireland and comply with their tax obligations.

In our view, rather than introducing further restrictions and complexity, policymakers should consider a redesign of Ireland's interest deductibility provisions to rebalance the effect of the comprehensive protections already afforded within the existing corporation tax code, with those now applicable under recently introduced anti-hybrid rules and extended transfer pricing rules, in addition to the ATAD ILR.

We believe that this redesign should reflect a general test for permitting a deduction for interest expense that is incurred for a business or commercial purpose, similar to the regime which exists in Germany for the deductibility of interest costs. Certain targeted measures within Irish tax law, such as bond-washing or interest on capital gains, could be preserved by policymakers.

4.5. Exit Tax

Q12. Please outline what in your view the impacts, if any, of participation exemption and/or branch exemption regimes might be on Ireland's Exit Tax rules. Do you foresee any synergies or risks in this space?
Q13. Please identify how particular design features of the exemption regimes could have positive or negative impacts in this context.

As Ireland currently has a worldwide tax system, the exit tax rules contained in section 627 TCA 1997 do not apply to foreign branches. However, ATAD envisages that exit tax should apply in circumstances where a taxpayer transfers assets from its head office to its PE in another Member State or in a third country insofar as the Member State of the head office no longer has the right to tax the transferred assets due to the transfer. Therefore, in adopting a foreign branch exemption, it would be necessary to amend the exit tax provisions contained in section 627 TCA 1997 to ensure they are fully aligned with the ATAD provisions.

The transfer of assets by a head office to a foreign branch could result in a charge to exit tax arising in circumstances where the underlying capital gain has not been realised by the branch. In such circumstances, a taxpayer may wish to elect not to apply a foreign branch exemption and therefore, it would be essential to ensure that the exit tax rules would not apply if such an election is made.

4.6. Schedule 24

Q14. Do you believe that a review and simplification of Schedule 24 could be feasible and sufficient, instead of changing to participation exemption and/or branch exemption regimes? How might this simplification be achieved?
Q15. What in your view are the relevant considerations in terms of any simplification of Schedule 24?
Q16. In the event of Ireland moving to participation exemption and/or branch exemption regimes, what simplifications, if any, could be considered for the remaining credit system of double taxation relief - including in respect of foreign-source interest

Schedule 24 contains the rules for computing a foreign tax credit available on foreign source income where there is a double taxation treaty in force. It also, critically includes unilateral relief provisions which apply where there is no double taxation treaty. The detailed rules cover entitlements to credit, deduction, pooling and carry-forward which apply to foreign income in the form of royalties, interest, branch profits and dividends.

Schedule 24 has been amended on a piecemeal basis over time since 1997 to reflect policy changes and European case law which has resulted in the operation of the relief for foreign credit becoming increasingly complex and administratively burdensome for taxpayers.

While the introduction of a participation exemption for dividends and a foreign branch exemption must be the priority, we would also urge for the simplification of Schedule 24. Such simplification is necessary even following the adoption of a participation exemption for dividends and a foreign branch exemption as Schedule 24 would continue to apply to foreign income which is outside the scope of such exemptions. However, in simplifying Schedule 24, it would important that any unrelieved tax credit carried forward would continue to be available for offset and the benefit of unilateral relief be preserved.

With the implementation of the GloBE rules including a minimum effective tax rate of 15%, we believe that it is now appropriate for policymakers to consider eliminating the distinction between trading and non-trading activities. In the absence of such a change, we believe that a reformed Schedule 24 could distinguish between income sources on the basis of income derived from the company’s trading income taxable at 12.5% and passive investment income taxable at 25%.

A rewrite of the legislative measures which underpin the operation of double tax credit relief is necessary to make the provisions easier to read and more straightforward to administer in practice. However, there are also components of Schedule 24 which, if

simplified, would alleviate the administrative burden. For example, the rules regarding the pooling and carry forward of credits are exceptionally complex and differ depending on the category of income even though there does not appear to be any clear rationale for this differing treatment.

We believe the varying treatment between different categories of income (for example, interest and royalties) in determining foreign tax credits and the pooling and carry forward of excess credits should be addressed. In our view, ensuring there is consistency of treatment across the different categories of income would streamline the current system and address much of the complexity faced by businesses in applying Schedule 24.

Different rules apply under Schedule 24 depending on whether the foreign income is received from a tax treaty country or whether unilateral relief applies. However, in many instances the outcome where unilateral relief applies as opposed to where there is a tax treaty can be very similar. We believe consideration could be given to aligning the rules for double taxation relief on income from tax treaty countries with the rules which apply to income received from a non-tax treaty country.

Section 21B TCA 1997 provides that certain dividends received by an Irish resident company may be taxable at the 12.5% rate of corporation tax rather than the 25% passive rate, with a credit for underlying tax suffered on the trading profits where certain conditions are met. The application of the 12.5% rate is by election of the company. However, making an election under section 21B can add complexity due to the credit pooling rules which requires excess credits on 12.5% dividends be offset against dividends taxed at 12.5% on a carry forward basis.

4.7. Interaction with Anti-Hybrid Rules

Q17. Please outline how territorial participation exemption and/or branch exemption regimes could impact on Ireland's Anti-Hybrid rules. Do you foresee any synergies or risks arising from the change?
Q18. Please identify any specific design features of exemption regimes that could have positive or negative impacts in this context? Please elaborate.
Q19. Please identify any adaptations to Ireland's Anti-Hybrid rules that should be considered in conjunction with a transition to such exemption regimes.

Section 835AB TCA 1997 is an important provision in Ireland's anti-hybrid rules. It addresses the application of Ireland's anti-hybrid rules in the context of worldwide tax systems to ensure that the rules only operate to neutralise actual economic hybrid mismatches and not technical hybrid mismatches.

In adopting a participation exemption for dividends and/or a foreign branch exemption in Ireland, it would be important for section 835AB to be retained, as the application of the provisions would continue to be required in certain circumstances to ensure that the anti-hybrid rules are confined to actual economic hybrid mismatches. For example,

if a company does not avail of a foreign branch exemption, the provisions of section 835AB would still be relevant. In addition, section 835AB would have application where another jurisdiction operates a worldwide system of taxation.

4.8. Interaction with the Two-Pillar Solution

Q20. Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for the way in which the two pillar solution is implemented in Irish tax law? Are there any potential synergies or risks with the implementation of the two-pillar solution and such exemption regimes?

Pillar One of the OECD Inclusive Framework Two-Pillar Solution to address the tax challenges arising from the digitalisation of the economy concerns the re-allocation of profits to market jurisdictions. We do not believe the implementation of the Pillar One rules into Irish law would impact on the introduction of a participation exemption and/or a branch exemption.

Pillar Two consists of two inter-locking domestic rules, collectively referred to as the GloBE rules, and a treaty based Subject to Tax Rule (STTR). The implementation of the GloBE rules into Irish law will result in a top-up tax applying on profits arising in a jurisdiction where the effective tax rate, determined on a jurisdictional basis, is below the minimum rate of 15%.

In our view, the implementation of the GloBE rules, together with the other protections in the corporation tax code, including CFC rules and exit tax, should alleviate any concerns regarding the potential for base erosion in adopting a participation exemption and/or a branch exemption.

Adopting a participation exemption would align the Irish corporation tax code with the GloBE rules. Under the GloBE Model Rules,[7] an entity's financial accounting net income or loss would be adjusted to exclude dividends to arrive at that entity's GloBE income figure. The rationale for this approach is that dividends are generally subject to a participation exemption.[8]

The detailed rules on the operation of the STTR have not yet been published. Policymakers would need to consider the interaction of the STTR with a foreign branch exemption. For example, if a payment is made to a branch, it is unclear whether it is the tax paid in the jurisdiction of the home office or the jurisdiction for the branch that would be taken into account for the purpose of the STTR.

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[7] OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm.

[8] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/abb4c3d1-en, paragraph 181.

Policymakers would also need to consider the outcome of the current US tax reform proposals, the interaction with Pillar Two and the potential impact on Ireland.

4.9. Ireland’s Double Taxation Treaty Network

Q21. Do you foresee potential impacts, arising from moving to participation exemption and/or branch exemption regimes, for Ireland’s tax treaties?
Q22. Should the renegotiation of Ireland’s tax treaties, as respects the Elimination of Double Taxation article, be considered in the event of the enactment of participation exemption and/or branch exemption regimes? Would this be necessary? If so, how might it be feasible to accomplish this in a targeted and efficient manner?
Q23. Would any amendment of Ireland’s worldwide tax system to allow for exemption of foreign dividends, gains or branch income necessitate a review of specific tax treaties in Ireland’s network, where previously Ireland’s worldwide charge would have ensured taxation of such dividends, gains or branch income? Alternatively, could such taxation be ensured by limiting the scope of any exemptions enacted in domestic law?

Implementing a participation exemption and/or a branch exemption in Ireland would require amendments to the Irish corporation code. We do not believe that such amendments to domestic legislation would directly impact Ireland’s tax treaty network as the intended purpose of a participation exemption and a branch exemption would be to avoid the incidence of double taxation. However, going forward, as Ireland re-negotiates its double taxation treaties in the normal course, it would be appropriate for such treaties to reflect the existence of a participation exemption and/or branch exemption in Irish tax law.

Article 10 of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI) provides anti-abuse rules for PEs situated in third countries that are not taxed in the state of residence and that are taxed at a low rate in the third country. As Ireland does not currently have a branch exemption it reserved its position under Article 10.

Article 10 seeks to deny double taxation treaty benefits where branch income benefits from an exemption from tax in the state of the head office but the branch tax rate would be less than 60% of the tax rate in the state of the head office. This could arise if Ireland introduces a foreign branch exemption and the branch profits are taxed at a rate of less than 60% of the relevant Irish rate.

Interestingly, Article 10 of the MLI does not apply where the income of the branch “*is derived in connection with or is incidental to the active conduct of a business carried on through the permanent establishment (other than the business of making, managing or simply holding investments for the enterprise’s own account, unless these*

activities are banking, insurance or securities activities carried on by a bank, insurance enterprise or registered securities dealer, respectively)."

4.10. Transitional Arrangements and Other Issues

Q24. Do you foresee impacts in relation to the matters identified above or any other matters related to transitional arrangements?
Q25. In your view, what other relevant considerations should be taken into account? You may wish to consider this question in the context of the recent OECD Inclusive Framework Two-Pillar agreement.

We have outlined our comments regarding the interaction of introducing a participation exemption and/or a branch exemption with the implementation of the OECD Inclusive Framework Two-Pillar Solution into Irish law at paragraph 4.8 of this submission.

In tandem with the introduction of a participation exemption for dividends, consideration should also be given to amending section 626B to ensure that it aligns with the dividend exemption. For example, the definition of relevant territory for the purpose of section 626B could be aligned with the list of qualifying jurisdictions for the participation exemption for dividends. We believe that consideration should also be given to the removal of the trading requirement for section 626B to apply.